An Update-September 14th

By Peter Scholtz

A long, long time ago, last summer, the economy was prospering. Unemployment hit 40 year lows and worker wage growth outpaced executive pay for the past two years. It was working. Then the virus hit. The instant and severe shock of shutting down so many industries overnight, led the economy and market into a straight decline. As you have undoubtedly witnessed, though, the stock market did not collapse and stay down. Clearly, as we have pointed out in our prior commentary, the response by the government has been so strong it was able to mitigate most of the market damage.

Although the Federal Government has enacted substantial fiscal stimulus packages, in reviewing the past several months, it seems without question that the Federal Reserve ("the Fed") has had the biggest impact. The Fed has been creating liquidity at the fastest rate since the 1970's. M2 money supply is up 23% year-over-year. You would think this amount of new money would drive up the price of goods and services, i.e., inflation, since the Fed is rapidly debasing the dollar. It hasn't. However, the price of investment assets such as Real Estate, Rare Art, Stocks, Bonds, Gold, and BitCoin have all been strongly moving up. The tidal wave of money is finding its way all over the place. The Fed has also made it clear that it does not want to raise short term interest rates, currently near zero, for roughly two years. The Fed would even welcome some old fashion inflation, and therefore will not restrict credit for quite some time. This is a monetary environment that is extremely advantageous to investors.

The virus, however, remains front and center and its path is still the critical variable determining the economy and markets for the next year or two. The government can only do so much for so long. I have been somewhat surprised on the virus in the United States, in terms of its duration and path. I assumed it would follow the pattern we have seen in China, South Korea, Japan, Italy and until recently, Spain. The typical path is for the virus to go straight up in reported cases, and after a couple of months rapidly subside to low levels. The United States has done a poor job of coping with the Covid. Although New York has followed this typical pattern, the rest of the country has experienced a wave going through it, that only just recently is on a gliding path downward. This is a nasty disease with sometimes permanent damage to the heart, lungs, and other organs, even in people with mild symptoms, but we now have better treatments, more testing and the death rate is getting very low. We are doing a better job with this. The new Abbott Labs test announced two weeks ago is quick and easy. Results are obtained in fifteen minutes without any special equipment. This test will enable us to rapidly pinpoint breakouts and react in a more timely fashion. Hospitals have gotten the equipment and knowledge they need, dramatically decreasing death rates. This is progress, but we need a vaccine soon if we are going to put this behind us.

My initial estimates of the vaccine deployment have been too pessimistic. Given the lengthy test period, as well as the time to produce and distribute, I had originally thought we would not have a vaccine until next summer. One analyst pointed out that no company would begin production without knowing if their vaccine is approved first. For Moderna, this would be a financial death blow since they have no other products or sales. Yet, with positive early stage data, some government financial support and the seeming

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desire to help the greater good, several companies have decided to manufacture vast quantities of vaccine before approval anyway. This has cut the time down time to meaningful deployment by months. At several companies, dosages are in full production. The accelerated testing process for approval has also cut down the time to market, so assuming the vaccine works, it should be approved some time in November. Initially, health care workers and caretakers will be vaccinated. The population at large should start getting the vaccine by year-end.

The scientific community is very optimistic on developing an effective vaccine. It is true that the vaccine is not a cure-all, but we don't need one. Vaccines typically are 60-70% effective which sounds low, but people who get sick after being vaccinated have a mild case of sickness. A vaccine will be effective enough such that each sick person on average will infect less than one other person (Ro). This means that the infection rate will decline and eventually die out, probably late 2021 or early 2022. The second half of next year should show very low numbers.

The Covid effect on the economy has been obvious. It now seems that all regions appreciate proper distancing behavior which has led to lower case numbers. The virus wave has by now hit all the large U.S. population areas. The irresponsible among us have already partied and gotten sick, for the most part. The partial re-open has generated strong numbers in a variety of industries. Although there will be no full recovery until a vaccine, I have observed that people are learning how to cope and have increased their activities using a variety of precautionary measures. People go to more stores, restaurants, fly, take trains, and even outdoor activities without taking on much incremental risk. People are learning work-arounds. At this point, we simply need to get to year-end and the vaccine, the imaginary light at the end of the long 2020 tunnel.

Economically, investors are waiting for the government to issue the next phase of economic relief. The program should last three months and essentially bridge the gap to a vaccine. More and more, a deal is becoming elusive with both sides trying to make the other look bad ahead of the election. It will be a little messy. Trump played his hand poorly by attempting to keep the economy open for the sake of less economic damage and thus, his re-election chances. Not only did this increase the ultimate cases and death tolls, the slow virus wave across the country prolonged the media pain. Recently, seventy-one percent of portfolio managers polled through a Wall Street firm thought Biden would win the election. He was far ahead in the polls and it makes the possibility of the Democrats sweeping all three branches a real possibility. Trump's numbers from now to the election will definitely improve and seem to be in lock step with the progression of the virus. Ultimately, the election will be closer than it looks.

Policy under Progressive leadership, assuming they capture the House and the Senate, would bring about higher taxes on the upper middle class (read entrepreneurs), and more regulation. If you think getting a bank loan is torture now, just wait. These are not pro-growth, pro-job creation policies, but as I have tried to explain to my conservative clients, the world will not end. The economy will still grow, albeit more slowly. It is too bad that the unemployed would have to suffer longer than need be, but that is the reality of these proposed policies, not commentary. If the Republicans maintain the Senate, bad economic policy will be severely hampered, and the outcome could be quite positive. Having a more subdued president would appeal to many, so a Republican Senate and Biden as President might be the optimal outcome for investors.

So, in conclusion, another stimulus package will bridge us to the vaccine. Reports of vaccine progress will embolden more economic activity and improve Trump’s polling numbers as we approach the election. Although many businesses will struggle through this year, some will thrive, and as we move into 2021, the economy will embark on the second wave of re-opening. Economic growth should be quite strong as many companies are more dormant than dead. It will appear to be a boom (emphasize appear), similar to the numbers now. With so much slack in the labor market and manufacturing, however, we will embark on a long expansion and next year’s president will get all the credit. All assets will do well. Money will remain cheap. Job and economic growth will remain strong for all of next year. Stocks will do well.